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No. 84-

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1984

J. DONALD GOODWIN,
Petitioner

v.

ELKINS & CO., ROBERT G. HAYDEN,
RICHARD SICHENZIO, and GABRIEL F. NAGY,
Respondents

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTION PRESENTED

Is a person denominated as a general partner in a written partnership agreement, but who has merely a passive role and is led to reasonably expect that profits would be earned through the efforts of others, precluded *as a matter of law* from ever stating a claim that his general partnership interest constitutes a security under the Securities and Exchange Act of 1934?

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Petitioner J. Donald Goodwin respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Third Circuit entered in this proceeding on March 14, 1984.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 730 F.2d 99 (3d Cir. 1984), and appears in Appendix "A" hereto. The opinion of the District Court for the Eastern District of Pennsylvania is reported at 558 F.Supp. 1375 (E.D.Pa. 1983) and appears in Appendix "B" hereto.

JURISDICTION

The judgment of the Court of Appeals for the Third Circuit was dated and entered on March 14, 1984 and this petition for certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

STATUTES AND RULE INVOLVED

This case involves Sections 3(a)(10) and 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §§78c(a)(10) and 78j(b); Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. 240.10b-5; the Pennsylvania Uniform Partnership Act, 59 Pa.C.S. §§301 *et seq.*; and the Pennsylvania Uniform Limited Partnership Act, 59 Pa.C.S. §§501 *et seq.*, the texts of which are set forth in pertinent part in Appendix "C".

STATEMENT OF THE CASE

A. *Facts*

Petitioner J. Donald Goodwin ("Goodwin"), commenced an action in the United States District Court for the Eastern District of Pennsylvania against Elkins & Co., a Pennsylvania limited partnership, and several of its general partners, (all defendants will hereinafter be collectively referred to as "Elkins"), alleging, *inter alia*, violations of Section 10(b) of the Securities Exchange Act of 1934 ("1934 Act") and Rule 10b-5 promulgated thereunder, arising from Elkins' false and misleading statements and omissions regarding whether merger negotiations were being pursued between Elkins and another company. Those fraudulent actions occurred at the very time when Goodwin was considering and was ultimately persuaded by Elkins to terminate his partnership interest. The jurisdiction of the District Court was invoked under sections 10(b) and 27 of the 1934 Act, 15 U.S.C. §§78j(b) and 78aa; and general federal question jurisdiction, 28 U.S.C. §1331, and also on the basis of diversity of citizenship, 28 U.S.C. §1332(a).

Goodwin alleged in his complaint that management of Elkins rested in its executive committee and that Goodwin's role, and that of other general partners not on the executive committee, was, without any choice on their part, passive. Thus, although denominated as general partners, the terms of the Partnership Agreement and the manner in which Elkins was actually operated left so little control in the hands of Goodwin and other passive general partners who did not serve on the executive committee, that the arrangement distributed control with respect to those general partners, including Goodwin, as it did with the limited partners.

Elkins moved to dismiss Goodwin's securities law claims pursuant to Fed.R.Civ.P. 12(b)(6) on the grounds that Goodwin's partnership interest in Elkins did not constitute a security and that the complaint, therefore, failed to state a claim under the 1934 Act.

B. *Contractual Rights of General Partners in Elkins*

The Elkins Agreement of Limited Partnership ("Partnership Agreement") seemingly provided for certain powers to be exercised by general partners in the control of their investment: (1) to elect or replace a managing partner by vote of a majority in interest of the general partners; (2) to call for the removal of the executive committee named in the Partnership Agreement by vote of a majority of the general partners and to elect successors by vote of a majority in interest of the general partners; and (3) to give approval or make decisions by a majority in interest of the general partners. With regard to the latter category of approvals and decisions, the Partnership Agreement provided that Elkins would be managed by the managing partner under the supervision of the executive committee "subject to the approval or decisions of the General Partners". Despite that provision, however, the Partnership Agreement also provided that the managing partner shall have full power to execute the policies established by the executive committee "subject only to the supervision of the Executive Committee."[1]

Despite these voting rights, the Partnership Agreement showed on its face that if the managing partner and all other members of the executive committee acted unanimously, they would control a majority of interest in the partnership if any one additional partner voted with them because the vote of the executive committee totalled 35.2% and only 36.6% was needed to constitute

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1. The Partnership Agreement, besides generally according the executive committee management power over Elkins through its supervision of the managing partner, also specifically made the establishment of policies for Elkins the principal function of the executive committee and gave the executive committee full power and authority to approve or disapprove the appointments of managers of branch offices and departments made by the managing partner.

such a majority in interest. Goodwin had the second lowest interest, being 2.3% out of a total allocated vote of 73.2%.

Also, to the extent that management of Elkins was subject to the approval or decisions of the general partners, such "supervision" consisted of a veto-type function which could be entirely illusory if partners could not get sufficient information to review the management and policies of the executive committee and managing partner.

C. *Proceedings Below*

The District Court granted Elkins' 12(b)(6) motion to dismiss Goodwin's federal securities law claims and found as a matter of law that Goodwin's general partnership interest was not a security.

The Court of Appeals affirmed upon the opinion of The Honorable Leonard I. Garth as concurred in by the Honorable Collins J. Seitz and the Honorable Edward R. Becker, who both filed separate opinions. Judge Garth held as a matter of law that a general partnership interest could *never* be a security within the ambit of the federal securities laws because, without regard to the attributes of the Elkins or any partnership agreement, the *legal* interest and role assumed by a general partner pursuant to the Pennsylvania Uniform Partnership Act (or presumably the partnership law of the other 47 states that have adopted the Uniform Partnership Act) "extends well beyond the permitted role of a passive investor" such that a general partner "is unavoidably, even if unwillingly a part of the operation of the enterprise."

Judges Seitz and Becker merely concurred because, although agreeing with the outcome, they both chose to confine their examinations solely to the literal terms of the Partnership Agreement. Both found the powers granted to a general partner appearing on the face of the Partnership Agreement to be determinative of whether

Goodwin could ultimately prove a set of facts showing that, in actuality, he could not control the management of Elkins and did not have access to the information necessary to protect his investment.

REASONS FOR GRANTING CERTIORARI

1. The Third Circuit's Decision Is In Direct Conflict With The Decisions Of The Fifth And Sixth Circuits Which Will Lead To Uneven And Unfair Enforcement Of The Federal Securities Laws Between The Circuits

Judge Garth's opinion, adopted as the opinion announcing the judgment of the Third Circuit (hereinafter referred to as the "Opinion Announcing the Judgment of the Third Circuit"), identified the Fifth Circuit's decision in *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981), *cert. denied*, 454 U.S. 897 (1982), as the leading precedent in the area of determining whether a general partnership interest can be and is a security. Judge Garth specifically concluded, however, that because of his analysis of the *legal* powers vested in Goodwin by reason of the Uniform Partnership Act, he could not accept the Fifth Circuit's conclusion in *Williamson* that general partnership interests in some circumstances can be securities. As the Opinion Announcing the Judgment of the Third Circuit stated, "Were we to accept *Williamson*, then Goodwin would be entitled to introduce evidence to support his allegation that he had little or no power in the Elkins firm," [2] (App. at A-13 n. 10), and a reversal rather than an affirmance of the ruling of

2. In fact, it is specifically noted in the Opinion Announcing the Judgment of the Third Circuit that the language of Goodwin's complaint literally, and the court believed intentionally, put the pleadings within the circumstances posited in *Williamson* as examples of when a general partnership interest would meet the requirements of *SEC v. W. J. Howey*, 328 U.S. 293 (1946), for determining the existence of an investment contract and would fall within the protection of the federal securities laws. (App. at A-14).

the District Court would be mandated. The conflict between the Third and Fifth Circuits could not be clearer.

Unlike the Third Circuit, the Fifth Circuit concluded in *Williamson* that the partnership interest must be examined in its *factual* as well as its legal context because the determination of whether a general partnership interest constitutes a security is dependent upon the extent to which the purported general partner is relying upon the efforts of others for the success of his investment. Although the applicable state partnership law was substantially identical to that relied upon by the Third Circuit, the Fifth Circuit recognized that "the mere fact that an investment takes the form of a general partnership or joint venture does not inevitably insulate it from the reach of the federal securities laws." 645 F.2d at 422.

The Fifth Circuit's analysis included a specification of at least three different factual patterns which, if established, would demonstrate the existence of a security, despite the fact that the investment was in the form of a general partnership. One of those examples (and the example specifically pleaded by Goodwin in his complaint and noted and rejected by the Third Circuit), is that if the investor can establish that an agreement among the parties leaves so little power in the hands of a general partner that the arrangement in fact distributes power as would a limited partnership, the general partnership interest would, at least in the Fifth Circuit, be a security for purposes of the federal securities laws. 645 F.2d at 423.

The *Williamson* Court recognized that a plaintiff, in establishing the existence of a security, has a *"factual burden"* to bear to prove that he has so little power. 645 F.2d at 425 (emphasis added). The Opinion Announcing the Judgment of the Third Circuit prevents Goodwin, or any general partner, from meeting this burden. In fact, directly contrary to the *Williamson* analysis, the Opinion Announcing the Judgment of the Third Circuit states

that, "Even if the Elkins Partnership Agreement contained the most draconian restrictions on the rights of non-management partners, such partners would still possess a quantum of powers and responsibilities which, as a matter of law, would preclude their interest from being a security under the Act."

The Opinion Announcing the Judgment of the Third Circuit totally skews any reasonable approach to application of the federal securities laws by refusing to examine rights of partners *inter sese* and instead placing the sole focus upon the statutory power of a partner to represent the partnership with regard to third parties. 59 Pa.C.S. §321. (App. at A-16). The Opinion Announcing the Judgment of the Third Circuit holds for this reason that the partnership agreement and all attendant factual circumstances of how the partnership actually functions and is managed are totally irrelevant. However, this analysis totally ignores the examination required upon the fundamental criteria of control over the management of the enterprise, such control being the determinative factor as to whether profits were expected to be earned through the efforts of others. *SEC v. W. J. Howey*, 328 U.S. 293 (1946). Responsibilities and obligations to third parties, statutorily imposed for the protection of those third parties do not expand a general partner's rights to control and manage the enterprise and produce profits. The latter rights are governed by the relations of the partners one to another and are to be determined, as provided by statute, in the first instance by any agreement among the partners. 59 Pa. C.S. §331.

Besides these obligations to third parties, the statutory powers accorded to general partners to inspect books and records and demand information of all things affecting the partnership, 59 Pa.C.S. §332 and 333, are also accorded to limited partners, 59 Pa.C.S. §524. Thus, even a general partner's access to information is not such as to give him any added ability to control and manage the enterprise.

Moreover, in making their decision solely on the basis of the Partnership Agreement, the two concurring judges also clearly and firmly rejected the Fifth Circuit's analysis in *Williamson*. The Fifth Circuit noted that on the face of any partnership agreement a partner-investor seemingly has control over his investment and the ability to protect himself from a managing partner. 645 F.2d at 424. This fact, however, did not dissuade the Fifth Circuit from finding that a security might exist. Rather, the court held that the effect of this circumstance was simply to impose a burden on the investor to show facts which would demonstrate that *in actuality* he was unable to exercise meaningful partnership powers.[3] For instance, in the Fifth Circuit's view, if partnership interests were sold to a sufficiently large number of people, a general partnership interest could constitute an investment contract because the interest might be so diluted that there would be no effective partnership control and a partnership vote would more closely resemble a corporate vote.

In contrast to the Fifth Circuit's position, the mere existence of a vote, without regard to its effectiveness, was enough to persuade the concurring judges that a security could not exist. Directly contrary to the holdings of the Fifth Circuit in *Williamson*, the concurring judges imposed the Partnership Agreement as an insurmountable barrier to ever finding a general partnership interest to be a security. The concurring judges required a much stricter test than was imposed in *Williamson* — that the substance of the partnership agreement be called into question and that it be shown that the rights granted by the agreement could not be exercised at all or were shams, as opposed to the *Williamson* test of show-

3. As one court has phrased the burden imposed by *Williamson*, the investor must show "by contract or factual necessity certain partners have little or no control over the management of the enterprise." *McConnell v. Frank Howard Allen & Co.*, 574 F.Supp. 781, 786 (N.D. Cal. 1983) (emphasis added).

ing that the rights, even if exercised, were not effective or meaningful.

In an apparent effort to avoid a grant of certiorari by this Court, the Third Circuit attempts to minimize the blatant conflicts between its opinion and that of *Williamson* by stating that the *Williamson* holding that general partnerships can constitute securities is dicta. (App. at A-14 n.11). Nevertheless, the conflict between the decision of the Third Circuit and decision in *Williamson* is more than just one of principle because numerous other courts have consistently adopted and followed the *Williamson* analysis, it being the leading and definitive case at the time of those decisions. *See, e.g., SEC v. Professional Associates*, 731 F.2d 349 (6th Cir. 1984); *Kim v. Cochenour*, 687 F.2d 210, 213 n.7 (7th Cir. 1982); *Gordon v. Terry*, 684 F.2d 736 (11th Cir. 1982), *cert. denied*, 103 S.Ct. 1188 (1983); *Rogers v. Cowley*, Fed.Sec.L.Rep. (CCH) ¶99,178 (N.D.Ga. 1983); *McConnell v. Frank Howard Allen & Co.*, 574 F.Supp. 781 (N.D. Ca. 1983) (although general partners could remove managing partner, approve a sale or sell all assets, since the rights were similar to those which a limited partner could exercise under California law, the *Williamson* test of of whether "the agreement in fact distributes power as would a limited partnership" was applied, and general partnership interests were held to be securities); *Caleel v. Frietag Realty, Inc.*, No. 82 C 1094 (E.D.Ill. October 14, 1983) (whether interest qualified as security under three *Williamson* examples raised issue of fact precluding summary judgment despite contention that joint venture agreement by its terms gave plaintiff a right to control the venture equal to other partners); *Pfohl v. Pelican Landing*, Fed.Sec.L.R. (CCH) ¶99,461 (N.D.Ill. 1983); *Morrison v. Pelican Land Development*, Fed.Sec.L.R. (CCH) ¶98,863 (N.D.Ill. 1982); *Funds of Funds v. Arthur Anderson & Co.*, 545 F.Supp. 1314 (S.D.N.Y. 1982).

The Sixth Circuit has recently joined the Fifth Circuit in requiring that a general partnership or joint venture interest be examined in its factual context in determining if it is a security. In an opinion issued less than a month after the Third Circuit decided this case, the Sixth Circuit has again noted its approval of the *Williamson* opinion and the factual examples set forth therein of when a general partnership can constitute a security. *SEC v. Professional Associates*, 731 F.2d 349 (6th Cir. 1984). Directly contrary to the result reached in the Third Circuit, the Sixth Circuit affirmed a finding by the district court that a joint venture agreement providing for a manager of the venture but permitting all joint venturers to have a voice in major decisions affecting the venture was a security at least as to those of the investors that were passive. The district court reached that decision after a hearing for preliminary injunction.

The issue of whether a general partnership can be a security is being raised each day with increasing frequency, which has resulted in a welter of cases, noted above, using varied approaches and interpretations of the federal securities laws to resolve these issues. The time is now ripe for this Court to offer its guidance on the proper resolution of these issues in order that some uniformity of approach can be achieved and the confusion and uncertainty that presently reigns can be alleviated.

2. This Case Presents The Court With The Opportunity To Decide An Important Question Of Federal Securities Law That Requires Resolution At This Time

The Third Circuit is the first Circuit to flatly hold that a general partnership interest can never be found to be a security within the meaning of the 1934 Act. The issue of whether a general partnership interest can be a security is in particular need of resolution at this time not only because of the conflict in the Circuits but also

because of the continuing trend to expand the availability of exemptions from the registration and prospectus delivery requirements of the Securities Act of 1933, 15 U.S.C. §§77 *et seq.* ("1933 Act"), which necessarily increases reliance on the antifraud provisions of the securities laws.

It is through Regulation D, 17 C.F.R. §§230.501-230.506, a series of Rules adopted by the S.E.C. on March 3, 1982, that the S.E.C. has most recently manifested this trend to expand exemptions. For instance, in Rule 504, one of the Rules comprising a part of Regulation D and which provides an exemption from the registration requirements of the 1933 Act for limited offers and sales of securities not exceeding an annual aggregate amount of $500,000, the S.E.C. increased the aggregate sales price limitation of $100,000 contained in former Rule 240 to $500,000. As the Commission noted, Rule 504 was designed to continue the unanimous opinion of the commentators and the S.E.C. "that there is a need for a *de minimis* exemption from federal regulation, and that state Blue Sky requirements and the antifraud provisions of the federal securities laws would provide adequate protection." S.E.C. Securities Act Release No. 6389, March 8, 1982, [1981-82 Transfer Binder] Fed.Sec.L.R. (CCH) ¶83,106.

Moreover, Rule 505, which is also a part of Regulation D and which provides a transactional exemption for offers and sales by an issuer to an unlimited number of accredited investors and to thirty-five non-accredited investors in an aggregrate amount not exceeding $5 million, expanded the similar exemption previously available under Rule 242 and made it available to all noninvestment company issuers "regardless of legal structure or line of business". *Id.* Previously, Rule 242 had been limited to certain corporations.

As noted by the S.E.C., because of the deregulation, increased emphasis must be placed upon the antifraud provisions of the securities laws to protect investors. The

wholesale cut-back made by the Third Circuit in the application of the federal securities laws to general partnership interests prevents the mechanism of the antifraud provisions, which the S.E.C. envisioned would act as a stop-gap to prevent any harmful consequences from its deregulation, from properly operating and jeopardizes the numerous investors in such entities. This is a result not intended by the S.E.C. at the time of its deregulation.

Indeed, the SEC has sucessfully argued that passive joint venturers who, by reason of the provisions of the joint venture agreement, were accorded a voice in major decisions affecting the venture, in fact were investors in a security, *SEC v. Professional Associates*, 731 F.2d 349 (6th Cir. 1984), and argued strongly in its amicus brief with regard to the petition for rehearing filed in *Williamson* that general partnership interests could be passive investments that could qualify as securities. The gap that the Third Circuit has created in the protections envisioned by the S.E.C. must be addressed at this time and resolved.

Moreover, the impact of this decision will be far reaching because of the number of businesses conducted in the partnership form. Since this case arises through the application of the Uniform Partnership Law which has been adopted in 48 states and is thus applied throughout the nation, it provides a unique opportunity for this Court to address the issue in a context that is not limited to this particular case but has an important bearing with regard to most, if not all, state partnership laws.

Under the reasoning presented in the Opinion Announcing the Judgment of the Third Circuit, a general partnership agreement which grants an investor the title "general partner" as opposed to "limited partner", without any further means of control over the investment or the other general partners than those accorded to limited partners, prevents such an interest from being construed as a security as a matter of law merely by reason

of the provisions of the Uniform Partnership Act. Although the investor may have no awareness of that statute, and the partnership agreement itself may severely circumscribe a general partner's power to manage the partnership such that the investor makes the investment with the expectation that profits will be earned primarily through the efforts of others, he will not be accorded any of the protections which it is the policy of the federal securities laws to accord to such investors. The application of the securities laws can be easily circumented by doing little more than attributing a title to the investor.

The importance of this often recurring issue in the context of increased dependence in the antifraud provisions of the securities laws to protect investors merits the attention of the Court at this time.

CONCLUSION

For the foregoing reasons, this Petition should be granted and a writ of certiorari should be issued to review the decision of the Third Circuit.

Respectfully submitted,

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APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 83-1295

J. DONALD GOODWIN,

Appellant

v.

ELKINS & CO., ROBERT G. HAYDEN, RICHARD SICHENZIO, and GABRIEL F. NAGY,

Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA
(Civil Action No. 82-4069)

Argued December 13, 1983

Before: SEITZ, *Chief Judge*, GARTH, and BECKER, *Circuit Judges*

(Opinion Filed March 14, 1984)

OPINION ANNOUNCING THE JUDGMENT OF THE COURT

GARTH, *Circuit Judge*.

In this case, we are asked to give further definition to what constitutes a security within the meaning of federal securities law. Goodwin asserts that his partnership contract in a brokerage firm is a security interest, enabling him to invoke the provisions of the Securities Ex-

change Act in seeking vindication of his claims. The district court held otherwise, and dismissed Goodwin's claim brought under federal securities law, and remitted his common law claims to arbitration. We affirm.

I.

Plaintiff J. Donald Goodwin brought suit against the brokerage firm of Elkins & Co.[1] Goodwin, a former general partner of Elkins, alleged that he was induced to sell his partnership interest back to the firm based upon false representations made by the defendants. His complaint charged a violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78(b) (1976), and of SEC Rule 10(b)(5), promulgated thereunder. It also raised state common law claims of fraud and breach of fiduciary duty. Jurisdiction was based on 28 U.S.C. §1331 (1976) (federal question jurisdiction), under the court's pendent jurisdiction, and also under 28 U.S.C. §1332(a) (1976), since there existed diversity of citizenship.

Elkins moved to dismiss the federal securities claim under Fed. R. Civ. P. 12(b)(6), and to compel arbitration of the remaining state claims, since the Elkins Partnership Agreement contained an arbitration clause. The district court granted the motion to dismiss, finding that Goodwin's partnership interest could not constitute a "security" within the meaning of the Act. It also remitted the state claims to an arbitrator. It is from these rulings that Goodwin appeals.

II.

As required by a Rule 12(b)(6) motion, all the factual allegations of Goodwin's complaint must be taken as

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1. The complaint also named as defendants Robert Hayden, Richard Sichenzio, and Gabriel Nagy, as individual partners of the firm. All defendants will hereafter be referred to collectively as "Elkins."

true. Goodwin was a general partner with Elkins, and a registered representative. He had been associated with that firm for more than 20 years when, in 1981, he became dissatisfied with the management policies of the firm, and announced his resignation as of October 1981. He was prevailed upon by several partners of the firm to withdraw his resignation and continue with the firm until at least March 31, 1982, however, so as to avoid undue prejudice to the firm. In February 1982, Goodwin was advised that it would be more convenient if his withdrawal from the firm were to take effect as of January 1, 1982. Goodwin agreed to that suggestion, and his withdrawal from the firm was effectuated as if it had occurred on January 1, 1982. Goodwin asserts that, in connection with the February agreement, he was falsely and fraudulently advised that no sale or merger of the firm was planned; and that the defendants fraudulently concealed from him the fact that such negotiations were then being actively pursued. On March 17, 1982, when Goodwin would still have been a partner but for the February agreement, the Elkins firm was purchased by, and merged into, Bache, Halsey, Stewart, a large New York brokerage house. In a transaction which was financially advantageous to the general partners of the Elkins firm. In his suit, Goodwin sought to recover the difference between the amount paid to him upon his withdrawal (representing the value of his interest calculated as of January 1, 1982) and the amount which would have been paid to him had his interest been valued as of the date originally agreed upon, March 31, 1982.

Two issues are raised on this appeal. First, Goodwin contends that the district court erred in finding as a matter of law that his complaint could not state a claim under federal securities law. He also argues that the state law claims of fraud and breach of fiduciary duty are not within the scope of the Partnership Agreement's arbitra-

tion clause, and therefore it was error to send the proceedings to an arbitrator. We address these issues in turn.[2]

III.

A.

In enacting the Securities Exchange Act of 1934, we recognize that Congress intended to provide remedial legislation, which in turn must be liberally construed. *Tcherepin v. Knight*, 389 U.S. 332, 336 (1967). As the Supreme Court has noted, "[t]he definition of 'security' in the Securities Exchange Act of 1934 is quite broad. The Act was adoped to restore investors' confidence in the financial markets, and the term 'security' was meant to include 'the many types of instruments that in our commercial world fall within the ordinary concept of a security.' " *Marine Bank v. Weaver*, 455 U.S. 551, 555-56 (1982) (quoting H.R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933)).

Nevertheless, the scope of federal securities laws is not without limitation, and Congress did not intend to

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2. As a preliminary matter, we note that appellate jurisdiction properly lies in this matter as a final decision under 28 U.S.C. §1291 (1976). The defendants moved to dismiss the plaintiff's federal claims and to stay proceedings and compel arbitration. (The defendants' motion was entitled "Motion of Defendants to Dismiss and to Stay Proceedings and Compel Arbitration.) The district court granted the defendants' motion by dismissing the first count of Goodwin's complaint and then staying the proceedings pending the submission of all other claims to arbitration.

A fair reading of the record, and of the defendants' motion leads us to construe the action taken by the district court as one compelling arbitration. We have held that such orders are appealable under §1291. Gavlik Constr. Co. v H.F. Campbell Co., 526 F.2d 777 (3d Cir. 1975). *Cf.* Moses H. Cone Memorial Hospital v. Mercury Constr. Corp., 103 S. Ct. 927 (1983)(order staying proceedings brought in federal court to compel arbitration, pending outcome of parallel state court suit, is appealable as final order under §1291). *But see* Kirschner v. West Co., 300 F.2d 133, 134 (3d Cir. 1962)(in banc)(order staying proceedings pending arbitration in absence of motion to compel arbitration held not final for purposes of §1291).

create a federal cause of action for common fraud. *Marine Bank*, 455 U.S. at 556. It is therefore our task to determine whether the general partnership interest in a brokerage firm as described in Goodwin's complaint comes within the definition of the term "security."[3]

The seminal case in this area, *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), defined an investment contract[4] as:

> a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led

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3. Section 3(a)(10) of the 1934 Act as set forth in 15 U.S.C. §78c(a)(10), provides:

> (a). . . When used in this chapter, unless the context otherwise requires—
>
> (10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest of participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general any instrument commonly known as a 'security'; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity is likewise limited.

4. Although an "investment contract" is only one of the several categories of securities ennunciated in the Securities Exchange Act (*see supra* note 3), we find that *Howey* and its progeny set out the dispositive definition in this case. We note that neither party argues that Howey does not announce the applicable analysis. Moreover, of the other categories of securities noted in §3(a)(10) of the Act, the only other category which is colorably relevant is a "certificate of interest or participation in any profit-sharing agreement." Although a general partnership might literally fall within this description, the Supreme Court has held that "[a profit-sharing] provision alone is not sufficient to make that agreement a security." *Marine Bank v. Weaver*, 455 U.S. 551, 560 (1982). We are satisfied that, regardless of whether an interest is characterized as an "investment contract" or as a "profit-sharing agreement," it still must meet the requirements of *Howey*.

> to expect profits solely from the efforts of the promoter or a third party . . .

Id. at 298-99.[5]

Goodwin acknowledges the inherent difficulty in treating a general partner as the holder of a "security" under the Howey test, since by definition he is presumed to be personally involved in the management of the enterprise. Goodwin alleges, however, that in reality, he was invested with so little power and responsibility under the Elkins Partnership Agreement that his actual position was no more than that of a limited partner, and that effective control of the firm rested exclusively with the Managing Partner and the Management Committee of the firm. Goodwin sks that he be allowed to introduce evidence to support that allegation. We find, however, that even if his assertions were to be proved, the interest which Goodwin claims does not satisfy the requirement of a "security."

Even if the Elkins partnership may be deemed as a "common enterprise," as that term was used in *Howey's* definition of an investment contract, we are not persuaded by Goodwin's argument that he, as a general partner, could be "led to expect profits solely from the efforts of the promoter or a third party," and thus have his interest classed as an investment security. A general partner in Goodwin's firm, as in other similar firms, is unavoidably, even if unwillingly, a part of the operation of the enterprise. As the Sixth Circuit noted, "[t]he managerial powers vested in general partners and the express right of inspection of documents gives them the kind of leverage and ability to protect themselves that

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5. While Howey interpreted a "security" as defined in §2(1) of the Securities Act of 1933, 15 U.S.C. §77(b)(1), it has been consistently held that this definition is essentially the same as that contained in the Securities Exchange Act of 1934, 15 U.S.C. 78(b), the statute which is a issue here. *E.g., United Housing Foundation, Inc. v. Forman,* 421 U.S. 837, 847 n.12 (1975).

takes them outside the intended scope of the '34 Act." *Odom v. Slavik*, 703 F.2d 212, 215 (6th Cir. 1983).

It is true that this Court has noted that the term "solely," as used in the *Howey* test (i.e. "a person invests his money in a common enterprise and is led to expect profits *solely* from the efforts of [another]"), is not to be read literally when considering the efforts made by an investor. *Lino v. City Investing Co.*, 487 F.2d 689, 692 (3d Cir. 1973). *Accord, SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973). An investment contract or interest may still be classed as a security even if the investor is required to perform such duties, as long as those duties are "nominal or limited and would have little direct effect upon receipt by the participants of the benefits promised by the promoters." 487 F.2d at 692.

It is at this point that the views of the members of this panel to some extent diverge. Although the Court is unanimous that Goodwin's interest in the partnership does not qualify as a security under federal securities laws, Chief Judge Seitz and Judge Becker in their respective concurring opinions would confine their examinations to the Partnership Agreement, and so hold. While I agree with their conclusion, I would hold that Goodwin's interest does not qualify as a security primarily because the role of a general partner, *by law*, extends well beyond the permitted role of a passive investor.[6]

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6. I emphasize that, in characterizing Goodwin's role in the Elkins firm, I have been careful to observe the limitations placed upon us by the fact that this appeal arises from an order dismissing a complaint under Fed. R. Civ. P. 12(b)(6). Unlike Judge Becker, I believe we must take as true all factual allegations contained in *Goodwin's pleadings*, and must rule only on the facial validity of his complaint. To the extent that I rely on sources outside of the complaint to reach my conclusions, such reliance is based only upon relevant state statutes defining the role of general partners, of which judicial notice may be taken. *See infra* note 9.

Accordingly, to the extent that I reach the same result as my two colleagues, but do so wholly by reference to the Pennsylvania Partnership Act, this portion of the opinion (the remainder of Part III.A.) expresses only my views and not those of Chief Judge Seitz or Judge Becker.

Under Pennsylvania's Partnership Act, Pa. Stat. Ann. tit. 59, §§301-365 (Purdon Supp. 1983),[7] a general partner is an agent of the firm, and the act of every partner, with only certain exceptions,[8] binds the partnership. *Id.* §321. Admissions or representations made by a partner concerning partnership affairs is evidence against the partnership. *Id.* §323. Notice to a partner of any matter relating to partnership affairs operates as notice to the partnership. *Id.* §324. A wrongful act or breach of trust by a partner renders the partnership liable, *Id.* §§325-26, and each partner is subject to unlimited liability for partnership losses. *Id.* §327.

Each partner has equal rights in the management and conduct of partnership business, subject to the provisions of the partnership agreement. *Id.* §331(5). Each partner, however, has what amounts to an absolute veto power over any act sought to be performed by the other partners which contravenes the partnership agreement. *Id.* §331(8).

It is manifest that any person who possesses the powers, rights, and responsibilities described above cannot have invested his capital with the expectation of profits derived *solely* from the efforts of others, and

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7. Paragraph 2 of the complaint alleges that Elkins & Co. is a Pennsylvania limited partnership. App. at 2. Pennsylvania's Limited Partnership Act, in turn, provides that the powers, rights, and liabilities of a general partner in a limited partnership shall be determined by the law which would apply if there were no limited partners, Pa. Stat. Ann. tit. 59, §523 (Purdon Supp. 1983). The legal position of Goodwin within the Elkins firm is therefore determined by the Pennsylvania Partnership Act. *Id.* §§301-365.

8. *See infra* text at 16-17.

therefore cannot be the holder of a "security" as intended by the Act. Whatever subjective perceptions Goodwin may have entertained about his position in the firm, and whatever may have been the role he actually assumed, the *legal* interest which he enjoyed does not fall within the scope of the term "security" as intended by Congress. As noted by the court in *New York Stock Exchange v. Sloan*, 394 F. Supp. 1303 (S.D.N.Y. 1975):

> [T]he determination whether the partnership interest of a general partner is a security does not and should not hinge on the particular degree of responsibility he assumed within the firm. The fact that a partner may choose to delegate his day-to-day managerial reponsibilities to a committee does not diminish in the least his legal right to a voice in partnership matters, nor his responsibility under state law for acts of the partnership.

Id. at 1314. *Accord, Hirsch v. du Pont*, 396 F. Supp. 1214, 1220 (S.D.N.Y. 1975), *aff'd*, 553 F.2d 750 (2d Cir. 1977).

B.

Even if we were to limit our consideration of Goodwin's arguments to the Partnership Agreement which was annexed to Elkins' Motion to Dismiss,[9] the

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9. Although Goodwin attached a number of exhibits to the complaint, the one exhibit he did not attach but to which he referred in the text of his complaint was the 1981 Partnership Agreement. Elkins submitted a copy of the Partnership Agreement as an "Exhibit" to its motion to dismiss, and argued that Goodwin retained powers and duties under the Agreement, which put him outside the ambit of the federal securities laws. Before us, the defendants argued strongly that the provisions of the Agreement precluded relief under the federal securities laws.

In normal course on a Rule 12(b)(6) motion, we look only to the pleadings and take all factual allegations contained in the complaint as true. *E.g.*, Rogin v. Bensalem Twp., 616 F.2d 680, 685 & n.14 (3d Cir. 1980). I recognize that there is some authority for permitting reference to uncontradicted exhibits which were not made part of

Partnership Agreement on its face reveals that non-management general partners in the Elkins firm retained significant managerial prerogatives. When these provisions are read in conjunction with the Pennsylvania statutes described above, it is evident that Goodwin's interest did not qualify as an investment security within the meaning of the federal securities law. We reach this conclusion with full recognition of the fact that Goodwin had been given no opportunity in the district court to flesh out his argument through discovery.

For example, the Partnership Agreement provides that any general partner may participate in the nomination, election, or removal of the Executive Committee and the Managing Partner. Partnership Agreement ¶ 6, App. at 45. The general partners as a group also maintain ultimate managerial control through oversight of the Executive Committee and the Managing Partner. *Id.* ¶ 7(a), App. at 45-46. General partners must approve new admissions into the partnership and involuntary terminations of the partnership. *Id.* ¶¶ 21(a)(i) & 23(a), App. at 60-61. All of these powers, even if Goodwin failed to exercise them, provided him with a substantial role in the management of the firm notwithstanding any restrictions specified by the Agreement.

NOTE — *(Continued)*
the complaint but which were attached to moving papers seeking dismissal. *See* Provident Nat'l Bank v. Frankford Trust Co , 468 F. Supp. 448, 450 & n.2 (E.D. Pa. 1979); 5 Wright & Miller, Federal Practice and Procedure 1357 at 593. *See infra* Opinion of Judge Becker. Because of our disposition, however, I believe we need not decide at this time the issue of how to treat a Rule 12(b)(6) motion when uncontradicted exhibits are before the court but were not made part of the complaint.

To the extent that Elkins bases its arguments on its "Exhibits," and in particular on the Partnership Agreement, such arguments might have been better made in connection with a motion for summary judgment rather than a motion to dismiss. Whether or not summary judgment would have been proper at this juncture, given the amount of discovery allowed and not allowed to the parties by the district court, is an entirely different question from the one presented here. *But see infra* Opinion of Chief Judge Seitz.

C.

In support for his position that a general partnership interest could conceivably constitute a security, Goodwin relies upon *Williamson v. Tucker,* 645 F.2d 404 (5th Cir. 1981), *cert. denied,* 454 U.S. 897 (1982). In *Williamson,* the Fifth Circuit had before it a real estate venture which took the form of a general partnership. The district court had found that such interests could not constitute securities, and dismissed the suit under Fed. R. Civ. P. 12(h)(3) for lack of subject matter jurisdiction. The Court of Appeals reversed, and in doing so commented on the possibility that a general partnership interest could constitute a security. It first acknowledged what we have stated previously: that interests in general partnerships as a rule do not constitute security interests. It continued:

> Although general partners and joint ventures may not individually have decisive control over major decisions, they do have the sort of influence which generally provides them with access to important information and protection against a dependence on others. Moreover, partnership powers are not in the nature of a nominal role in the enterprises which a seller of investment contracts would include in order to avoid the securities laws; on the contrary, one would expect such a promoter to insist on ultimate control over the investment venture. An investor who is offered an interest in a general partnership or joint venture should be on notice, therefore, that his ownership rights are significant, and that the federal securities acts will not protect him from a mere failure to exercise his rights.

645 F.2d at 422.

The *Williamson* court, however, would apparently hold open the possibility, however faint, that a general partnership interest can, under unusual circumstances,

meet the *Howey* requirements and thereby fall within the protection of the Act. The court stated:

> [T]he mere fact that an investment takes the form of a general partnership or joint venture does not inevitably insulate it from the reach of the federal securities laws. . . . If, for example, the partner has irrevocably delegated his powers, or is incapable of exercising them, or is so dependent on the particular expertise of the promoter or manager that he has no reasonably alternative to reliance on that person, then his partnership powers may be inadequate to protect him from the dependence on others which is implicit in an investment contract.
>
> Thus, a general partnership in which some agreement among the partners places the controlling power in the hands of certain managing partners may be an investment contract with respect to the other partners. In such a case the agreement allocates partnership power as in a limited partnership, which has long been held to be an investment contract. Similarly, one would not expect partnership interests sold to large numbers of the general public to provide any real partnership control; at some point there would be so many partners that a partnership vote would be more like a corporate vote, each partner's role having been diluted to the level of a single shareholder in a corporation. Such an arrangement might well constitute an investment contract.

645 F.2d at 422-23 (citations omitted). The *Williamson* court itself acknowledged, however, that the exception it would carve out to the general rule is a narrow one.

> [A]n investor who claims his general partnership or joint venture interest is an investment contract has a difficult burden to overcome. On the face of a partnership agreement, the investor retains substantial control over his investment and an abil-

> ity to protect himself from the managing partner or hired manager. Such an investor must demonstrate that, in spite of the partnership form which the investment took, he was so dependent on the promoter or on a third party that he was in fact unable to exercise meaningful partnership powers. A general partnership or joint venture interest can be designated a security if the investor can establish, for example, that (1) *an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership;* or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.

Id. at 424 (emphasis added).

If the reasoning in *Williamson* is accepted, then Goodwin's position might be more substantial than we find it.[10] The complaint explicitly alleged that:

> Despite the fact that certain passive partners, such as Goodwin, were denominated as general partners, the terms of the limited partnership agreement left so little control in the hands of Goodwin and other passive general partners who did not serve on the executive committee, that the arrange-

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10. Were we to accept *Williamson*, then Goodwin would be entitled to introduce evidence to support his allegation that he had little or no power in the Elkins firm. The docket sheets disclose, however, that the district court ruled on Elkins' motion to dismiss before Goodwin had the opportunity to conduct discovery or to develop a factual record.

> ment distributed control with respect to those general partners including Goodwin as it did with the limited partners.

Complaint ¶17, App. at 6. Quite literally, and no doubt intentionally, this language puts the pleadings within the exception enunciated in *Williamson*, which might protect the viability of the federal claim against a motion to dismiss, and allow a plaintiff to raise factual issues.[11]

Goodwin's sole argument under *Williamson* is that the Elkins Partnership Agreement so limited his power that he was, in essence, a mere limited partner. As we have noted, however, whether a partnership interest constitutes a security depends on the *legal* rights and powers enjoyed by the investor. Whatever may have

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11. We also noted that, to the extent *Williamson* would allow some forms of general partnerships to constitute "securities," it is arguably obiter dictum. The *Williamson* court was reviewing an order of the district court that dismissed a federal securities claim for *lack of subject matter jurdisdiction*. As the Fifth Circuit noted in its opinion, the test for subject matter jurisdiction under such circumstances is whether the plaintiff's federal claim "clearly appears to be immaterial and made solely for the purpose of obtaining jurisdiction or where such a claim is wholly insubstantial and frivolous." *Bell v. Hood*, 327 U.S. 678, 682 (1945). "A claim is insubstantial only if its unsoundness so clearly results from the previous decisions of this [the Supreme] court as to foreclose the subject and leave no room for the inference that the questions sought to be raised can be the subject of controversy." *Hagans v. Levine*, 415 U.S. 528, 538 (1974).

We agree that the claims raised in *Williamson*, and indeed the claims raised here, were not so devoid of merit and utterly frivolous as to require dismissal for lack of jurisdiction. That inquiry, however, is far different from the one we address here, i.e., whether dismissal under Fed.R.Civ.P. 12(b)(6) for failure to state a cause of action is warranted. The *Williamson* court did no more than to hold that federal jurisdiction had been established before remanding for further proceedings. It explicitly declined to discuss whether summary judgment could have been granted, 645 F.2d at 426, and was silent on the propriety of a 12(b)(6) motion. Its actual ruling, therefore, is inapposite to the proceedings presented here.

been the effect of the Partnership Agreement, we are not persuaded that it could so diminish the statutory powers of a general partner in the partnership, such as Goodwin, that the partnership interest which he possessed could qualify as a security.

We of course do not quarrel with the general proposition that the legal powers of a participant in a joint enterprise may be derived from private agreements and contracts, as well as public statutes. Indeed, we need look no further than *SEC v. Howey* itself for an example of a situation in which the interest created was defined primarily, if not solely, by an agreement between the parties.[12] Where, however, there exists both a statute which affects the rights and powers of participants in an enterprise, as well as a private agreement, then we must read the statute and the private agreement in conjunction with each other in order to determine the legal powers that results.[13]

Our analysis of the resultant legal powers vested in Goodwin leads to the conclusion that he still necessarily enjoyed such significant prerogatives in the operation of the firm that his interest could not be a "security." Taking as true Goodwin's allegations that the Elkins Partnership Agreement sought to limit severely his role in the management of the partnership, nevertheless, Pennsylvania's Partnership Act puts its own limitations on the extent to which a general partner can be so restricted. Significantly, a non-management general partner is still an agent of the firm, and indeed can *bind* the firm and conduct firm business with third parties in the same manner as a management partner, *even is such acts con-*

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12. *Howey* involved a private contract for the sale of plots in a citrus grove, along with a service contract to cultivate, harvest, and market the crops.

13. A private contract may of course not override a public law, but in many instances the statute explicitly allows its provisions to be altered by agreement. Our task, therefore, may simply be one of harmonizing the two different sources of substantive rights.

travene the provisions of the partnership agreement, unless the third party has actual knowledge of the non-management partner's lack of authority under the agreement. Pa. Stat. Ann. tit. 59, §321. Nor can an agreement absolve the partnership of liability for a partner's wrongful acts or breaches of duty, or absolve a partner from liability for partnership losses. Notice to a particular non-management partner would remain notice to the partnership, and his admissions would still be evidence against the firm. *See supra* text at 8-9.

Indeed, the major effect that a partnership agreement would appear to have, is on the rights of partners *inter sese*. Thus, a partnership agreement may modify a partner's right to a voice in management as that right relates *to other partners*. It could not, however, diminish the power of a partner to represent the firm outside the partnership, below what the Pennsylvania statute has set forth as a minimum. Even if the Elkins Partnership Agreement contained the most draconian restrictions on the rights of non-management partners therefore, such partners would still possess a quantum of powers and responsibilities which, as a matter of law, would preclude their interest from being considered a security under the Act.[14]

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14. The argument that an investor who was only one of many general partners would have such a diluted interest in the enterprise that his role would become analogous to that of a corporate shareholder is also unconvincing. *See Williamson*, 645 F.2d at 423. If we were to consider a large Wall Street law firm with 54 partners, as contrasted with a small close corporation of only 20 shareholders, we still would find the latter to comprise a "security" but not the former. General partners, no matter how many or few they may be, are still, as a group, legally responsible for the management of the firm. Shareholders, however, no matter how many or few they may be, have a legally circumscribed role in the management of a corporation. State corporation statutes uniformly invest exclusive power to manage the ordinary business affairs with the Board of Directors, and indeed the very concept of a corporation is one in which the control of assets is divorced from ownership.

We therefore conclude that a participant who holds a general partnership interest in an enterprise, at least as that interest is defined under Pennsylvania law,[15] does not possess a security within the meaning of federal securities law. We will therefore affirm the order of the district court which dismissed Goodwin's federal securities claims.

IV.

Since we find that the district court properly dismissed Goodwin's federal securities claims, his complaint is reduced to an action in diversity for fraud and breach of fiduciary duty under state law. Before discovery could commence, Elkins moved to compel arbitration of these state claims under the Partnership Agreement's arbitration clause. The district court agreed with Elkins, and remitted Goodwin's state claims to an arbitrator. For the reasons expressed below, we hold that arbitration was proper under the Agreement, and will therefore also affirm that portion of the district court's order which committed the state claims to arbitation.[16]

A.

The initial issue which confronts us is what law to apply in gauging the propriety of the district court's arbi-

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15. Pennsylvania has adopted the Uniform Partnership Act and the Uniform Limited Partnership Act, and therefore its provisions should be typical of most state statutes in this regard.

16. As the Supreme Court has stated, "Contracts to arbitrate are not to be avoided by allowing one party to ignore the contract and resort to the courts. Such a course could lead to prolonged litigation, one of the very risks the parties, by contracting for arbitration, sought to eliminate." *Southland Corp v. Keating,* No. 82-500, slip op. at 4 (U.S. JAN. 23, 1984).

Because we find that the federal securities claims were properly dismissed, the rule in *Wilko v. Swan,* 346 U.S. 427 (1953), which exempts securities claims from arbitration provisions, is inapplicable.

tration order. Although Elkins originally moved before the district court for arbitration under the Federal Arbitration Act, and has cited to that Act in its brief, both parties argue state law in discussing the Partnership Agreement's arbitration provision. Arbitrability, of course, is purely a matter of contract. *E.g. United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574 (1960); *Commercial Metals Co. v. Balfour, Guthrie & Co.*, 577 F.2d 264 (5th Cir. 1978); *United Steelworkers v. Crane Co.*, 456 F. Supp. 385 (W.D. Pa. 1978). In resolving such a question of contract, a federal court sitting in diversity would normally be bound by state law under the *Erie* doctrine.[17] In enacting the Federal Arbitration Act, 9 U.S.C. §§1-13, however, Congress intended to establish a uniform federal law over contracts which fall within its scope. Thus, if the Arbitration Act is deemed applicable, federal law applies in construing and enforcing an arbitration clause, even in those cases in which jurisdiction is based on diversity. *Huber, Hunt & Nichols, Inc. v. Architectural Stone Co.*, 625 F.2d 22 (5th Cir. 1980); *Becker Autoradio USA Inc. v. Becker Autoradiowerk GmbH*, 585 F.2d 39 (3d Cir. 1978); *Collins Radio Co. v. Ex-Cell-O Corp.*, 467 F.2d 995 (8th Cir. 1972). Indeed, it applies to proceedings in state courts as well as federal courts. *Southland Corp. v. Keating*, No. 82-500 (U.S. Jan 23, 1984).

To be included within the coverage of the Federal Arbitration Act, an arbitration provision must be contained in a "contract evidencing a transaction involving commerce," 9 U.S.C. §2. For the arbitration provision at issue here to be construed under federal law, therefore, the Elkins Partnership Agreement must be found to be a contract evidencing a transaction in interstate commerce. Such a finding, however, is a *factual* determination which must be made initially by the district court. Here, however, the district court made no

17. *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938).

findings on whether the Elkins Partnership Agreement constituted a contract evidencing transaction in commerce and did not state under what law it was committing the matter to arbitration. As we noted in *Gavlik Construction Co. v. H.F. Campbell Co.*, 526 F.2d 777 (3d Cir. 1975), "[t]he absence of these findings precludes our consideration of the applicability of the arbitration act." *Id.* at 784. Although it is certainly possible that the partnership agreement of a brokerage firm dealing with securities involves interstate commerce,[18] we cannot make this assumption without a proper factual predicate. "However much we may speculate on what may have been the nature of the performance required by the contract, it is impossible for us to determine on appeal whether the United States Arbitration Act applies. For to do so would require us to make an initial factual determination whether the contract evidence 'a transaction involving commerce' within the meaning of §2 of the Act." *Merritt-Chapman & Scott Corp. v. Pennsylvania Turnpike Commission*, 387 F.2d 768, 772 (3d Cir. 1967).

We could, of course, remand the matter to the district court for the requisite finding as to commerce if no other alternative were available. *Gavlik*, 526 F.2d at 784. We find, however, that whether federal or state law is applied makes no difference in the substantive result,[19] and therefore perceive no reason to prolong these proceedings. We will rely on state law in our discussion, al-

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18. *See Fox v. Merril Lynch Co.*, 453 F. Supp. 561 (S.D.N.Y. 1978) (employment contract which incorporated N.Y. Stock Exchange arbitration provisions involved interstate commerce and was governed by federal arbitration act); *Dickstein v. du Pont*, 320 F. Supp. 150 (D. Mass. 1970), *aff'd*, 443 F.2d 783 (1st Cir. 1971) (employment contract between account executive and member firm of N.Y. Stock Exchange, which contemplated that account executive would travel or solicit customers in other states involved interstate commerce); *cf. Tallis v. Kohlmeyer & Co.*, 551 F.2d 632 (5th Cir. 1977) (validity of arbitration clauses in application for allied membership in stock exchange governed by federal law).

19. *See infra* note 23.

though the same outcome would doubtlessly obtain if we were to apply the Federal Arbitration Act. We therefore turn to the substantive question of whether, under Pennsylvania law, Goodwin's claims of fraud and breach of fiduciary duty are within the scope of the Partnership Agreement's arbitration clause.

B.

Paragraph 31 of the Elkins Partnership Agreement contained the following provisions.[20]

> 31. *Arbitration.* Any controversy arising hereunder will be determined by arbitration pursuant to the Constitution and Rules of the Board of Governors of the New York Stock Exchange. If for any reason such arbitration is not possible, such controversy will be submitted to the American Arbitration Association for arbitration under its Rules but before a panel of at least three arbitrators. If possible, such arbitrators shall include one partner or a member firm of the New York Stock Exchange, one officer of at least the rank of vice president of a Philadelphia bank or trust company and one member of the Bar practicing in Philadelphia. The written decision of a majority of said arbitrators will be binding and conclusive upon the parties hereto.

On its face, the Elkins Agreement's arbitration clause is broad in sweep. "*Any controversy arising hereunder*" is committed to arbitration. It has been settled that such expansive clauses may cover not only disputes

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20. Although, in ruling upon the dismissal Goodwin's federal securities claims, we questioned without deciding whether it was appropriate to consider the actual text of the Elkins Partnership Agreement (*see supra* notes 6 & 9), examination of the Agreement is obviously warranted in determining the arbitrability of the state law claims. Since Elkins raises arbitration as an equitable defense, it is not only proper, but required that it produce evidence to support it.

arising during the life of an agreement, but also those which arise from its demise. The Pennsylvania Supreme Court dealt with a provision similar to the one in this case in *Waddell v. Schriber*, 465 Pa. 20, 348 A.2d 96 (1975) (*Waddell I*) (construing provision of N.Y. Stock Exchange Constitution which commits "any controversy between parties" to arbitration). The court held that:

> When parties create a contractual relationship which includes a broad arbitration agreement, they intend to include within the scope of arbitration any dispute arising from the termination of that contractual relationship unless they *clearly evidence a purpose to exclude such disputes.*

Id. at 101 (emphasis added).

Here, Goodwin complains that, in dealing with the termination of his interest in the partnership, Elkins acted tortiously by withholding pertinent information from him. Such a dispute, however, arises from the very provisions of the Agreement. Paragraph 27 of the Partnership Agreement provides:

> 27. *Valuation and Payment of Interests and General Partners.*
>
> (a) Upon the termination of the Partnership or the Membership of a General Partner . . . *the value of the interest of such Partner* (hereinafter referred to as the "retiring Partner") *in the Partnership will be determined by the Partnership as of the Inventory Date* subject to the right of the retiring Partner to request an audit (the cost of which audit shall be borne entirely by such Partner) by independent certified public accountants selected by the Partnership (who may be the independent certified public accountants regularly engaged by the Partnership), in accordance with generally accepted accounting principles consistingly applied and with such re-

> serves for contingencies or otherwise as may be deemed necessary or proper, subject to the following provisions:[21]

Disputes over the value of Goodwin's share of the Partnership upon termination, therefore, arise out of the Agreement itself, and would be arbitrable.

The fact that Goodwin's state claims are phrased in terms of "fraud" and "breach of fiduciary duty" does not remove them from the scope of the arbitration clause. Intentional torts even less connected to the actual terms of the contract have been found by Pennsylvania courts to be subject to arbitration. In *Waddell v. Shriber*, 238 Pa. Super. 241, 357 A.2d 571 (1976) (*Waddell II*), the court considered whether a claim for defamation was arbitrable,[22] when the alleged defamatory language was uttered in connection with the termination of a partnership interest. The *Waddell II* court noted:

> The NYSE constitution provides for the arbitration of "any controversy". While it is true that the intentional tort of defamation is not normally arbitrated, the agreement to arbitrate does not exclude this claim. The phrase "any controversy" is certainly broad enough to embrace tort as well as contractual disputes, the only limitation being that the dispute has its roots in the applicable relationship between the parties.

357 A.2d at 573. If defamation uttered in connection with the termination of a partnership interest is considered to be an arbitrable dispute, then it would seem *a fortiori* that fraud, committed while a party was actually executing the very provisions of the Agreement dealing with termination, is also arbitrable.[23] Such a dispute

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21. The Agreement then lists various rules and procedures to be used in arriving at value for the partnership.

22. *Waddell II* involved the same parties and agreements as did *Waddell I*.

23. Goodwin argues that *Waddell II* was wrongly decided, and need not control since it was decided only by an intermediate state

seems to us clearly to have "its roots in the applicable relationship between the parties."

The Elkins Partnership Agreement contains as broad an arbitration provision as is usually encountered in normal course. We find that it is broad enough to cover the disputes raised by Goodwin. His allegations of tortious conduct by the defendants, in connection with the termination of his partnership interest, fall squarely within the subject matter of the Partnership Agreement. Significantly, the parties did not "clearly evidence a purpose to exclude such disputes." *Waddell I*, 348 A.2d at 101. We therefore conclude that the district court prop-

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court. While it is true that we may not be bound by a lower state court's interpretation of state law if we are convinced that the Pennsylvania Supreme Court would hold otherwise, we find no indication that such is the circumstance here. *Waddell II* is wholly consistent with the policy of Pennsylvania, as announced by its Supreme Court, which encourages arbitration. *See Waddell I*, 348 A.2d at 99 (Supreme Court stating that "arbitration is favored by the courts"). In the absence of a starkly defined irregularity of decision, therefore, we decline to hypothesize a disagreement between the Pennsylvania Supreme Court and the state's intermediate appellate court.

We also note that the policy expressed both in *Waddell I* *Waddell II* favoring arbitration agrees with analogous pronouncements in federal law. In *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), the Supreme Court held that, under the Federal Arbitration Act, an allegation of *fraud in the inducement of the contract* was properly submitted under that contract's broad arbitration provision, absent a showing that the arbitration clause itself was induced by fraud. *Accord, Merritt-Chapman & Scott Corp. v. Pennsylvania Turnpike Comm'n*, 387 F.2d 768 (3d Cir. 1967). Here, Goodwin does not even challenge the validity of the Elkins Partnership Agreement itself, but merely challenges the manner in which the defendants conducted themselves in carrying out the Agreement's termination provisions. It is clear to us, therefore, that Goodwin's claims would be arbitrable under the Federal Arbitration Act. Although, as we have noted, state law controls here, "[i]n the absence of Pennsylvania authority to the contrary we shall assume that the Pennsylvania courts would take the view adopted by the Supreme Court of the United States." *Merritt-Chapman & Scott*, 387 F.2d at 771.

erly relegated Goodwin's state claims of fraud and breach of fiduciary duty to arbitration.

V.

The order of the district court dismissing Goodwin's federal securities claims, and directing that the remaining state claims be arbitrated, will be affirmed.[24]

SEITZ, *Chief Judge*, concurring.

While I join the judgment of the court affirming the order of the district court dismissing the federal claims and directing arbitration of the state claims, I write separately because I differ somewhat from my colleagues on the governing analysis.

Goodwin's complaint contained federal securities claims and state law claims for fraud and breach of fiduciary duty. Elkins moved to dismiss the federal securities claims under Fed. R. Civ. P. 12(b)(6) [failure to state a claim] and to compel arbitration of the state law claims under an arbitration clause in the Elkins partnership agreement. The district court dismissed the federal claims and ordered arbitration of the state claims.[1]

My first concern with Judge Garth's opinion is that it disposes of Goodwin's complaint by affirming the order of the district court which in granting the motion to dismiss took cognizance of the terms of the partnership agreement even though the agreement was not attached to the complaint.

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24. Our holding, in affirming the dismissal of Goodwin's securities claims and the arbitration of Goodwin's remaining state law claims, in no way intimates any view with respect to the merits of Goodwin's claims.

FOOTNOTES TO SEITZ, *CHIEF JUDGE*

1. I am doubtful that my colleagues correctly construe the arbitration order as one directing arbitration rather than staying the action pending arbitration.

True, the agreement was attached to the motion. However, before the district court could rely on it, it was required by Fed. R. Civ. P. 12(b) to treat the motion as a motion for summary judgment and, ordinarily, give the opposing party an opportunity to respond with any relevant material. This was not done. However, for reasons developed later, I am persuaded that the district court's failure to treat Elkins' motion as a motion for summary judgment was harmless error.

Turning to the federal claims, Judge Becker and I are in agreement that we need not decide here whether a general partner's rights and responsibilities under the Pennsylvania Uniform Partnership Act are sufficient to prevent a general partner's interest from being treated as a security for purposes of federal law. Goodwin's partnership interest was a security under *SEC v. Howey*, 328 U.S. 293 (1946), if there was an investment contract between Goodwin and Elkins. In their respective opinions, Judge Garth and Judge Becker have summarized the rights and responsibilities of general partners under the Partnership Agreement. Judge Becker and I agree that a general partner with this degree of participation in partnership affairs is not a security holder. *See, e.g., Odom v. Slavik*, 703 F.2d 212, 215 (6th Cir. 1983); *Hirsch v. DuPont*, 396 F. Supp. 1214, 1220-21 (S.D.N.Y. 1975), *aff'd*, 553 F.2d 750 (2d Cir. 1977); *NYSE, Inc. v. Sloan*, 394 F. Supp. 1303, 1314 (S.D.N.Y. 1975). I do not consider my conclusion to be inconsistent with the dicta in *Williamson v. Tucker*, 645 F.2d 404, 422-24 (5th Cir. 1981), *cert. denied*, 454 U.S. 897 (1981).

In *Lino v. City Investing Co.*, 487 F.2d 689, 693 (3d Cir. 1973), we held that if an agreement is not on its face an investment contract, and the plaintiff does not allege facts that call into question the substance of the agreement, the plaintiff is not a security holder, as a matter of law. A court's overriding concern, however, is to determine the "economic reality" of the enterprise. *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967). *See*

SEC v. Aqua-Sonic Products, 687 F.2d 577, 582-84 (2d Cir. 1982) (license agreement is an investment contract where optional management powers described in the agreement are a mere formality and unlikely to be exercised). I turn to the pertinent allegations in Goodwin's complaint.

Goodwin alleges that:

> 16. Pursuant to the terms of the Elkins limited partnership agreement, management was vested in Elkins' executive committee, and upon information and belief, many of Elkins' management decisions were made solely by the managing general partner.
>
> 17. Despite the fact that certain passive partners, such as Goodwin, were denominated as general partners, the terms of the limited partnership agreement left so little control in the hands of Goodwin and other passive general partners who did not serve on the executive committee, that the arrangement distributed control with respect to those general partners including Goodwin as it did with the limited partners.

The question under *Lino* is whether these allegations point to a significant variance between the terms of the Partnership Agreement and the allocation of management power in fact. Paragraph 16 alleges that the managing partner made many management decisions by himself. It is not clear that this allegation challenges the substance of the Partnership Agreement, which provides that "[t]he Partnership will be managed by the Managing Partner under the supervision of the Executive Committee subject to the approval or decisions of the General Partners." This language would seem to authorize the managing partner to make management decisions.

It is possible to interpret paragraph 16 as an allegation that the managing partner did not in fact respect the terms of the Partnership Agreement and had usurped

some unspecified amount of control.[2] Even under this interpretation of paragraph 16, the managing partner's alleged excesses could not convert Goodwin's partnership interest into a security. Goodwin does not allege that he and the other general partners were deprived of the management perogatives that the Partnership Agreement grants on its face, including the right to replace the managing partner by majority vote.[3]

The allegations in paragraph 17 of Goodwin's complaint pertain explicitly and exclusively to the allocation of management power pursuant to the terms of the Partnership Agreement. I have concluded above that this allocation of power does not make Goodwin a security holder.

Goodwin argues that he could not control the management of the firm and that he was dissatisfied with management decisions, but an unhappy minority partner does not a security holder make. *See Odom*, 703 F.2d at 215. Goodwin also argues that he was effectively denied access to the information necessary for him to protect his investment because Elkins failed to inform him of the alleged merger negotiations. Although the federal securities laws protect investors by requiring disclosure of certain kinds of information, *see, e.g., Tcherepnin*, 389 U.S. at 336, the federal securities laws are not properly invoked to protect one general partner from the deceit of his copartners.

Although I would treat the district court's order dismissing Goodwin's federal securities law claims as an order granting summary judgment in favor of Elkins, I

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2. Goodwin's complaint does not specify whether a particular managing partner allegedly exceeded his authority under the Partnership Agreement or whether succeeding managing partners exceeded their authority.

3. Under the Partnership Agreement, each general partner votes in proportion to his ownership interest. Limited partners have no voting power, and the Partnership Agreement explicitly prohibits their participation in the management or control of the partnership.

would affirm that order, albeit on grounds different from those on which Judge Garth relies. I join in the deposition of the state law claims.

BECKER, *Circuit Judge,* concurring:

I concur in the judgment of the Court, and in all but part III of Judge Garth's opinion. Moreover, I agree essentially with what Judge Garth has written in part III B. My difference with Judge Garth is that I would ground our decision solely upon the terms of the Elkins & Co. Limited Partnership Agreement, to which Goodwin was a signatory, and would not reach the arguments founded upon the Pennsylvania Uniform Partnership Act. Obviously this approach presupposes the view that the partnership agreement is properly before us in the present posture of the case. Judge Garth and Chief Judge Seitz have doubts on this point, but I believe that the agreement is properly before us and hence would dispose of the case on the narrower grounds of the partnership agreement, and then its legal effect.

Where, as here, the allegations of a complaint are based on underlying written documents, and the authenticity of those documents is unchallenged, I believe that a court may properly consider those documents on a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6), even if the documents are not formally attached to the complaint.[1] A contrary holding would enable plaintiffs to survive a 12(b)(6) motion where the terms of the document on which the claim is based would render the complaint insufficient as a matter of law, simply by refusing to attach the document to the complaint.[2] This is such a

FOOTNOTES TO BECKER, *CIRCUIT JUDGE*

1. The courts are divided on the question whether a plaintiff is required to attach a written contract to a complaint based thereon. *See* 2A J. Moore, Moore's Federal Practice §8.17[6] at 8-184. In this case the partnership agreement was attached as an exhibit to the Rule 12(b)(6) motion.

2. The Ninth Circuit indicated that it would reach that result in Townsend v. Columbia Operations, the court stated that the doc-

case.[3] Accordingly, I would hold that where a document is actually and necessarily relied upon in the allegations of a complaint, and its authenticity is conceded, the document may be considered by the court on a motion under Fed. R. Civ. P. 12(b)(6).[4] This approach would enable the district courts to dispose of claims which, in light of the documents on which they are based, are legally insufficient, without the necessity of allowing the extensive discovery generally required before passing on a motion for summary judgment.

I believe that the terms of the Limited Partnership Agreement dispose of Goodwin's securities claims as a matter of law, even if his allegations concerning management of Elkins & Co are accepted as true.[5] In order

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uments underlying the complaint in that case were "in substance" part of the complaint, even though they were not attached to the complaint. The court in *Townsend* did not, however, need to hold that the underlying documents could be considered on a rule 12(b)(6) motion, because it felt that the notice and opportunity to respond requirements for a summary judgment under Fed. R. Civ. P. 56 had been substantially met.

3. Goodwin, in his complaint, clearly relied on the terms of the limited partnership agreement. *See* ¶¶16, 17 of the complaint.

4. I am buttressed in this holding by the general rule that the interpretation of a written document is a matter of law for purposes of appellate scope of review. *See Emor, Inc. v. Cyprus Mines Corp.*, 467 F.2d 770, 773 (3d Cir. 1972). Where the written language of a contract or other document is dispositive of an issue as a matter of law, there is no reason for even the cursory factual discovery and presentation required by Fed. R. Civ. P. 56.

5. Because I take this position, I believe we could dispose of this case on the basis of the agreement even if we had to treat the motion to dismiss as a motion for summary judgment under Fed. R. Civ. P. 56. Since the partnership agreement renders Goodwin's complaint insufficient as a matter of law, factual proof of the allegations in the complaint would not be "material" to our deposition of the case. Therefore, there was no harm from the district court's failure to give Goodwin an opportunity to present factual rebuttal before granting the motion even if we treat it as one for summary judgment on the basis of legal insufficiency. I understand this to be Chief Judge Seitz's position as well.

to prove that his interest was a "security" within the meaning of the securities laws, Goodwin had to show that his interest in Elkins falls within the test announced in *Securities and Exchange Commission v. W.J. Howey Co.*, 328 U.S. 293 (1946), and its progeny.[6] That test basically attempts to separate passive investments from active, participatory interests in businesses. As Judge Garth's opinion points out, the Elkins agreement provides that general partners may participate in the nomination, election, or removal of the Executive Committee and the Managing Partner, that they retain ultimate control through the function of overseeing the decisions of the executive committee and the managing partner, and that they retain power over new admissions to the partnership and over involuntary terminations. I note that, in addition, the agreement provides that "[e]ach partner will devote substantially all of his business time and attention to the business of the partnership" (¶7(b)), that partners "will not, during the continuance of the Partnership, carry on or be concerned with or interested in . . . any other business of venture other than as herein provided" (¶7(c)), and that partnership interests may not be assigned (¶22).

These factors, taken together, negate the argument that the interest of partners in the firm was basically a passive investment. As I have noted above, in his complaint in this case Goodwin has relied on the terms of the agreement, actually and constructively, and has not alleged that the provisions referred to above were shams. Under these circumstances, the terms of the agreement conclusively determine that the general partnership interest created thereby is not a security. Goodwin's allegations concerning his non-participation in management therefore fail to state a claim under the securities law, whether or not they are true.

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6. *See* note 4 of Judge Garth's opinion.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

J. DONALD GOODWIN	:	Civil Action
v.	:	
ELKINS & CO., et al.	:	No. 82-4069

MEMORANDUM AND ORDER

FULLAM, *J.* MARCH 25, 1983

The defendants have filed a Motion to Dismiss all of plaintiff's claims under the federal securities laws, pursuant to F.R.C.P. 12(b)(6), and a Motion to Stay and Compel Arbitration of all other claims asserted in the Complaint. The relevant facts are gleaned from the pleadings.

Plaintiff was a general partner in the brokerage firm of Elkins & Company, and a registered representative. He had been associated with that firm for more than 20 years when, in 1981, he became dissatisfied with the management policies of the firm, and announced his resignation as of October 1981. He was prevailed upon to withdraw his resignation and continue with the firm until at least March 31, 1982, so as to avoid undue prejudice to the firm. In February 1982, plaintiff was advised that it would be more convenient if his withdrawal from the firm were to take effect as of January 1, 1982. Plaintiff acquiesced in that suggestion, and his withdrawal from the firm was effectuated as if it had occurred on January 1, 1982. Plaintiff asserts that, in connection with the February agreement, plaintiff was falsely and fraudulently advised that no sale or merger of the firm was in contemplation; and that the defendants fraudulently concealed from plaintiff the fact that such negotiations were then actively being pursued. On March 17, 1982, the Elkins firm was purchased by and merged into Bache, Halsey, Stewart, in a transaction which was fi-

nancially advantageous to the general partners of the Elins firm. Plaintiff seeks to recover the difference between the amount paid to him upon his withdrawal (representing the value of his interest calculated as of January 1, 1982) and the amount which would have been paid to him had his interest been valued as of the date originally agreed upon, March 31, 1982. Plaintiff also seeks punitive damages.

Plaintiff asserts violations of §10(b) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. §78j(b) and Rule 10b-5 promulgated thereunder, and, under state law, breaches of fiduciary duty and common law fraud. In addition to invoking federal-question jurisdiction under the Securities & Exchange Act, 15 U.S.C. §78(j)aa and 28 U.S.C. §1331, plaintiff asserts that the parties are of diverse citizenship and that the amount in controversy exceeds $10,000, so that 28 U.S.C. §1332(a) also establishes jurisdiction.

Paragraph 31 of the partnership agreement provides:

> "Any controversy arising hereunder will be determined by arbitration pursuant to the Constitution and Rules of the Board of Governors of the New York Stock Exchange."

In addition, it is undisputed that, in his application to the New York Stock Exchange for allied membership, plaintiff agreed to abide by the constitution and rules of the Exchange, which require that "any controversy" between allied members is to be resolved by arbitration. New York Stock Exchange Constitution Article VIII, Section 1.

It is clear that, with the possible exception of plaintiff's 10(b) claims, all of plaintiff's claims fall within the arbitration provision. As stated by the Pennsylvania Supreme Court in *Waddell v. Shriber*, 465 Pa. 20, 30 (1975):

> "When parties create a contractual relationship which includes a broad arbitration agreement, they intend to include within the scope of arbitration any dispute arising from the termination of that contractual relationship unless they clearly evidence a purpose to exclude such disputes."

On the other hand, claims of violation of the federal securities laws may be pursued in federal court irrespective of contractual provisions which would otherwise require arbitration, *Wilco v. Swan*, 346 U.S. 427 (1953); and there is authority for the proposition that if there is substantial overlap and duplication between arbitrable and non-arbitrable claims, it is inappropriate to sever the arbitrable claims and require their submission to an arbitration which would be largely duplicative of the judicial proceeding. *See, Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Haydu*, 675 F.2d 1169 (11th Cir. 1982); *Sawyer v. Raymond James & Associates, Inc.*, 672 F.2d 791 (5th Cir. 1981). The crucial question, therefore, is whether, on the facts pleaded, plaintiff can establish liability under the federal securities laws.

Accepting as true the averments in plaintiff's Complaint, it is clear that material misrepresentations and concealment of material facts occurred. The question is whether these were "in connection with" the purchase of a "security".

The seminal definition of a "security" is set forth in *SEC v. W.J. Howrey Co.*, 328 U.S. 293, 298-99 (1946), namely "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of a promoter or third party." Plainly, the interest of a general partner in the partnership would not ordinarily fit within that definition, in view of the control and participation of the partner, and the expectation of profit generated in part by his own efforts. As the parties recognize, however, there is authority for the conclusion that, in some cir-

cumstances, "the mere fact that an investment takes the form of a general partnership or joint venture does not inevitably insulate it from the reach of the federal securities laws." *Williamson v. Tucker*, 645 F.2d 404, 422 (5th Cir.), *cert. denied*, 454 U.S. 897 (1981). The *Williamson* court expressed the view that

> "[if a partner has] irrevocably delegated his powers, or is incapable of exercising them, or is so dependent on the particular expertise of the promoter or manager that he has no reasonable alternative to reliance on that person, then his partnership power may be inadequate to protect him from the dependence on others which is implicit in an investment contract." *Id.*, at 422-23.

But, as the court also noted,

"The federal securities acts will not protect [a partner] from a mere failure to exercise his rights."
Id., at 422.

That plaintiff was a general partner, with voting rights, and with the right to attend partnership meetings, and with the right of access to the partnership books and records, is undisputed. Notwithstanding plaintiff's earnest argument (suggesting that a fuller development of the factual background would disclose that plaintiff's minority interest, and non-membership on the management committee, and other circumstances, rendered him unable, as a practical matter, to exercise "real control"), I find it impossible to accept the contention that the partnership interest for which plaintiff was paid when he withdrew from the partnership can properly be deemed a "security" for purposes of §10(b) of the Securities & Exchange Act.

It is important to note that the few decisions in the courts of appeals and district courts suggesting that a general partnership interest may possibly constitute a "security" (the Supreme Court has never so held) all involved transactions more nearly resembling "invest-

ments" than the transactions here involved. When members of the general public are prevailed upon to invest in a joint real estate venture, for example, and when the fractional interests thus acquired are freely transferable to other members of the public, there is valid reason for holding that such investors are entitled to the protection of the federal securities laws notwithstanding the fact that the investors may technically have been cast in the role of general partners.

But a general partner in a brokerage firm is plainly in a very different position. Plaintiff devoted his entire working hours to the success of the venture; he did not simply "invest" in the enterprises and expect to derive profit soley from the efforts of others. His interest in the firm could not be sold or transferred.[1]

The gist of plaintiff's claims in this case is that he was induced by fraudulent misrepresentations and failures to disclose material facts to surrender his interest in the firm for less money than he should have received. That plaintiff bound himself to arbitrate this kind of dispute is abundantly clear. The policies of the federal arbitration statute are strong policies. The only impediment to compelled arbitration derives from the non-waiver provisions of the federal securities laws. But those provisions were enacted for reasons which do not apply to this plaintiff. As stated by the Supreme Court;

> "This arrangement to arbitrate is a 'stipulation', and we think the right to select the judicial forum is the kind of 'provision' that cannot be waived under

FOOTNOTE TO FULLAM, JUDGE

1. Both sides appear to assume that the transaction whereby plaintiff withdrew from the partnership and was paid the balance in his capital account, etc., pursuant to the applicable provisions of the partnership agreement, amounted to a "sale" of his interest in the firm. For present purposes, I shall make the same assumption; but I believe there is a serious question as to whether this is the kind of "sale" Congress had in mind when it enacted the Securities & Exchange Act.

§14 of the Securities Act. . . . While a buyer and seller of securities, under some circumstances, may deal at arms length on equal terms, it is clear that the Securities Act was drafted with an eye to the disadvantages under which buyers labor. Issuers of and dealers in securities have better opportunities to investigate and appraise the prospective earnings and business plans affecting securities than buyers. It is therefore reasonable for Congress to put buyers of securities covered by that Act on a different basis from other purchasers.

"When the security buyer, prior to any violation of the Securities Act, waives his right to sue in court, he gives up more than would a participant in other business transactions. The security buyer has a wider choice of courts and venue. He thus surrenders one of the advantages the Act gives him and surrenders it at a time when he is less able to judge the weight of the handicap the Securities Act places upon his adversary. . . .

"Two policies, not easily reconcilable, are involved. . . . Congress has afforded participants in transactions subject to its legislative power an opportunity generally to secure prompt, economical and adequate solution of controversies through arbitration if the parties are willing to accept less certainty of legally correct adjustment. On the other hand, it has enacted the Securities Act to protect the rights of investors and has forbidden a waiver of any of those rights. Recognizing the advantages that prior agreements for arbitration may provide for the solution of commercial controversies, we decide that the intention of Congress, concerning the sale of securities is better carried out by holding invalid such an agreement for arbitration of issues arising under the Act." *Wilco v. Swan,* 346 U.S. 427, 434-38.

I have concluded that, as a matter of law, that the general partnership interest surrendered by plaintiff was not a"security" within the meaning of §10(b). Plaintiff's claims under the federal securities laws will therefore be dismissed. As to the remaining claims, this action will be stayed, pending submission to arbitration.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

J. DONALD GOODWIN	:	Civil Action
v.	:	
ELKINS & CO., et al.	:	No. 82-4069

ORDER

AND NOW, this 25th day of March, 1983, it is ORDERED:

1. To the extent that plaintiff's Complaint asserts claims arising under the federal securities laws, the Complaint is DISMISSED.

2. In all other respects, this action is STAYED, pending submission of the parties' disputes to arbitration in accordance with §31 of the partnership agreement.

/s/ JOHN P. FULLAM

J.

APPENDIX C

SECURITIES EXCHANGE ACT OF 1934

Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. §78(c)(a)(10), provides as follows:

(a) *Definitions.* When used in this title [15 U.S.C. Sec. 78a *et seq.*, unless the context otherwise requires—

* * *

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, reorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance, which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), provides as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a na-

tional securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

SECURITIES AND EXCHANGE COMMISSION RULE

Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. 240.10b-5, provides as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (1) To employ any device, scheme, or artifice to defraud,
>
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

PENNSYLVANIA UNIFORM PARTNERSHIP ACT

Pertinent provisions of the Pennsylvania Uniform Partnership Act, 59 Pa.C.S. §§321, *et seq.*, read as follows:

> §321 *Partner agent of partnership as to partnership business*
>
> (a) *General rule.* — Every partner is an agent of the partnership for the purpose of its business, and the

act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member, binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority.

(b) *Absence of apparent authority.* — An act of a partner which is not apparently for the carrying on of the business of the partnership in the usual way, does not bind the partnership unless authorized by the other partners.

(c) *Limitations on authority of individual partners.* — Unless authorized by the other partners, or unless they have abandoned the business, one or more but less than all the partners have no authority to:

(1) Assign the partnership property in trust for creditors or on the promise of the assignee to pay the debts of the partnership.

(2) Dispose of the goodwill of the business.

(3) Do any other act which would make it impossible to carry on the ordinary business of a partnership.

(4) Confess a judgment.

(5) Submit a partnership claim or liability to arbitration or reference.

(d) *Effect of knowledge of restriction.* — No act of a partner in contravention of a restriction on his authority shall bind the partnership to persons having knowledge of the restriction.

§323. *Admissions or representations by partner*

An admission or representation made by any partner concerning partnership affairs within the scope of his authority as conferred by this chapter is evidence against the partnership.

§324. *Partnership charged with knowledge of or notice to partner*

Notice to any partner of any matter relating to partnership affairs, and the knowledge of the partner acting in the particular matter, acquired while a partner or then present to his mind and the knowledge of any other partner who reasonably could and should have communicated it to the acting partner, operate as notice to or knowledge of the partnership, except in the case of a fraud on the partnership committed by or with the consent of that partner.

§327. *Nature of liability of partner*

All partners are liable:

(1) Jointly and severally, for everything chargeable to the partnership under section 325 (relating to wrongful act of partner) and section 326 (relating to breach of trust by partner).

(2) Jointly, for all other debts and obligations of the partnership; but any partner may enter into a separate obligation to perform a partnership contract.

§331. *Rules determining rights and duties of partners*

The rights and duties of the partners in relation to the partnership shall be determined, subject to any agreement between them, by the following rules:

* * *

(5) All partners have equal rights in the management and conduct of the partnership business.

§332. *Partnership books*

The partnership books shall be kept, subject to any agreement between the partners, at the principal place of business of the partnership, and every partner shall at all times have access to and may inspect and copy any of them.

§333. *Duty to render information*

Partners shall render on demand true and full information of all things affecting the partnership to any partner, or the legal representative of any deceased partner, or partner under legal disability.

§335. *Right of partner to an account*

Any partner shall have the right to a formal account as to the partnership affairs:

(1) If he is wrongfully excluded from the partnership business or possession of its property by his co-partners.

(2) If the right exists under the terms of any agreement.

(3) As provided by section 334 (relating to partner accountable as fiduciary).

(4) Whenever other circumstances render it just and reasonable.

PENNSYLVANIA UNIFORM LIMITED PARTNERSHIP ACT

Section 524 of the Pennsylvania Uniform Limited Partnership Act, 59 Pa.C.S. §524, provides as follows:

§524. *Rights of a limited partner*

(a) *General rule.* — A limited partner shall have the same right as a general partner to:

(1) Have the partnership books kept at the principal place of business of the partnership, and at all times to inspect and copy any of them.

(2) Have on demand true and full information of all things affecting the partnership, and a formal account of partnership affairs whenever circumstances render it just and reasonable.

(3) Have dissolution and winding up by decree of court.

A True Copy:—

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

Office-Supreme Court, U.S.
FILED
JUL 13 1984
ALEXANDER L. STEVAS,
CLERK

No. 83-2038

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1984

J. DONALD GOODWIN,

Petitioner

v.

ELKINS & CO., ROBERT G. HAYDEN, RICHARD SICHENZIO, and GABRIEL F. NAGY,

Respondents

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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COUNTERSTATEMENT OF QUESTION PRESENTED

Whether the court properly held, on the record before it, that Petitioner's general partnership interest was not, as a matter of law, a security.

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Opinions Below

The opinion of the Court of Appeals is reported at 730 F.2d 99 (3d Cir. 1984), and is found in Petitioner's Appendix "A" (hereinafter the "Appendix"). The opinion of the District Court for the Eastern District of Pennsylvania is reported at 558 F. Supp. 1375 (E.D. Pa. 1983) and is found in Petitioner's Appendix "B".

Counterstatement of the Case

Petitioner, J. Donald Goodwin, commenced this action against Respondents, alleging that by reason of their misrepresentations he was induced to resign from Elkins & Co. (the Respondent limited partnership) ef-

fective January 1, 1982, to his financial detriment. Petitioner asserted claims under the Federal Securities laws, alleging that the surrender of his general partnership interest in Elkins constituted the sale of a "security" and accordingly, the alleged misconduct gave rise to a claim under Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5 thereunder. Petitioner also asserted claims under the common law.

Respondents moved to dismiss the claims asserted under the Federal Securities laws for failure to state a claim upon which relief could be granted. At the same time, Respondents moved to have the Court direct that the remaining claims — all under the common law — be arbitrated by reason of applicable provisions requiring arbitration *inter alia* in the Elkins partnership agreement. The District Court, per the Honorable John P. Fullam, granted the motion to dismiss the securities claims and to compel arbitration of the common law claims. The United States Court of Appeals for the Third Circuit affirmed.

REASONS FOR DENYING THE WRIT

A. The Decision of the Third Circuit Does not Conflict with the Decisions of Other Courts of Appeals.

The judges in the Court of Appeals each wrote a separate opinion, concluding, in affirming the motion to dismiss, that no security was involved. The guide-post for all three opinions was a recognition of the reality of Petitioner's legal powers and rights, and a recognition that the *existence* of legal powers and rights — not the degree of control over partnership affairs that could be or was exercised — was the dispositive factor in determining whether a security existed.

Chief Judge Seitz found that Petitioner's "rights and responsibilities" under the partnership agreement created a "degree of participation in partnership affairs" inconsistent with being the holder of a security. Appendix,

A-25. He then found that the complaint simply did not allege that Goodwin was *deprived* of the management prerogatives granted on the face of the partnership agreement. Appendix, A-27. Judge Becker recognized that the test announced in *Securities and Exchange Commission v. W. J. Howey Co.*, 328 U.S. 293 (1946), and its progeny "basically attempts to separate passive investments from active, participatory interests in business." Appendix, A-30. After considering the *powers* accorded Petitioner under the partnership agreement, Judge Becker concluded that they clearly negated investor status, a result reinforced by the lack of any allegation that the partnership agreement was a sham. Finally, Judge Garth found a "quantum of powers and responsibilities" (Appendix, A-16) inconsistent with security status both in the rights enjoyed under state partnership law as well as under the partnership agreement.[1]

The cases which address the issue of whether a general partnership interest can be a "security" look, at bottom, to the *existence* of legal powers and rights. Those cases which suggest that a general partnership interest can be a security do so when faced with invest-

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1. Petitioner contends that Judge Garth, whose opinion announced the judgment of the Court, rested his views on the statutory powers of a general partner as *in and of themselves* legally sufficient to preclude security status. Judge Garth, however, specifically stated that this portion of the opinion (Part III.A.) represented only *his* views. As Judge Garth stated (Appendix, A-8, emphasis supplied):

> Accordingly, to the extent that I reach the same result as my two colleagues, but do so *wholly by reference to the Pennsylvania Partnership Act*, this portion of the opinion (the remainder of Part III. A.) express only my views and not those of Chief Judge Seitz or Judge Becker.

Judge Garth then considered, in Part III.B. of the opinion, Petitioner's powers under the partnership agreement *in conjunction with* the provisions of state partnership law, and concluded that Petitioner's interest did not qualify as an investment security within the meaning of the federal securities law.

ment vehicles which, in effect, "masquerade" as general partnerships — vehicles organized in such a fashion so as evade the protections of the securities law and which, in reality, constitute *investment* vehicles with passive investors having *no* bona fide managerial powers or prerogatives.[2] The decision of the Third Circuit, consistent with the decisions of other Courts of Appeal, represents an effort — *in the context of the record before it* — to determine the *existence* of legal rights and powers and therefore whether the partnership interest at issue had the characteristics of an investment. Respondents therefore see no conflict between the decision of the Third Circuit and those of other Courts of Appeals.

B. The Case was Correctly Decided by the Court of Appeals.

Petitioner alleged that he had been a general partner of Elkins, a securities brokerage firm, for twenty years (Appendix, A-3). That Elkins was not an investment vehicle "masquerading" as a general partnership is alone confirmed by its long-standing existence and Petitioner's long-standing membership as a partner.

In addition, the terms of the partnership agreement reserved ultimate management functions to the general partners. As Judge Garth stated:

> For example, the Partnership Agreement provides that any general partner may participate in the nomination, election, or removal of the Executive Committee and the Managing Partner. Partnership Agreement ¶6, App. at 45. The general partners as a group also maintain ultimate managerial control

2. The language of *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981), *cert denied*, 454 U.S. 897 (1982), heavily relied on by Petitioner, was arguably if not in actuality dicta. Compare Appendix A-14 with A-25. Moreover, we submit the "test" articulated in *Williamson* simply established criteria to denominate whether a general partnership lacked *bona fides*.

through oversight of the Executive Committee and the Managing Partner. *Id.* ¶7(a), App. at 45-46. General partners must approve new admissions into the partnership and involuntary terminations of the partnership. *Id.* ¶¶21(a)(i) & 23(a), App. at 60-61. All of these powers, even if Goodwin failed to exercise them, provided him with a substantial role in the management of the firm notwithstanding any restrictions specified by the Agreement.[3]

Most importantly, Goodwin at no time alleged that Elkins was a sham general partnership whose partnership agreement was a sham (Appendix, A-30), nor denied that he in fact had the power of a partner under the partnership agreement (Appendix, A-27).

For these reasons, the decision of the Court of Appeals was manifestly correct.

C. The Result Urged by Petitioner Would Make Unsound Public Policy.

Petitioner would opt for a rule which would authorize a case-by-case inquisition behind every partnership agreement into the degrees of partner control to determine whether the control *exercised* was sufficiently meaningful. Such a rule would invite chaos.

Moreover, the rule sought by Petitioner would result in the needless meddling of the securities laws in the affairs of ongoing businesses organized as partnerships whose partners have active, participatory roles in the business itself. The notion of a security, and the concept

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3. Judge Becker further noted (Appendix, A-30):

[T]he agreement provides that "[e]ach partner will devote substantially all of his business time and attention to the business of the partnership" (¶7(b)), that partners "will not, during the continuance of the Partnership, carry on or be concerned with or interested in . . . any other business or venture other than as herein provided" (¶(c)), and that partnership interests may not be assigned (¶22).

of investment it imports, is antithetical to general partnerships which conduct ongoing businesses where partners have active, participatory interests but delegate management functions to certain persons elected from their number. As Judge Garth suggested, this could include a large Wall Street law firm with 54 partners. *See* Appendix, A-16. In a complex organization, delegation of powers is typically a managerial fact of life and any one partner, who may nonetheless have substantial legal powers and rights to participate in the management of the partnership, may find himself in the minority. Stripped to its essence, Petitioner really complains of his status as a minority partner who could not control the outcome of partnership business. The securities laws are not the cure for the malady, since the anti-fraud provisions are not intended to remedy every wrong that occurs in a partnership scheme. To apply the anti-fraud provisions as Petitioner urges would create an unwarranted intrusion of the federal securities laws into intra-partnership affairs, and result in an improper attempt to "federalize" the state law of partnership.

CONCLUSION

For the reasons stated above, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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4. Pursuant to Rule 28.1, Respondents make the following disclosure: Elkins & Co. is a general partnership. Neither Elkins nor any other respondent is a corporation nor has corporate parents, subsidiaries or affiliates. In 1982, various assets of Elkins were acquired by Bache Halsey Stuart Shields Incorporated, now Prudential-Bache Securities, Inc.